

**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

Michigan Electric Transmission Company, LLC)	
And Midwest Independent Transmission System)	Docket No. ER06-56-000
Operator, Inc.)	

**NOTICE OF INTERVENTION AND PROTEST
OF THE MICHIGAN PUBLIC SERVICE COMMISSION**

Pursuant to Rules 211 and 214(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. §§ 385.211 and 385.214(a)(2) (2005), the Michigan Public Service Commission ("MPSC") hereby submits its Notice of Intervention and Protest in the captioned proceeding. As set forth more fully below, Michigan Electric Transmission Company, LLC ("METC") and the Midwest Independent Transmission System Operator, Inc. ("Midwest ISO") (collectively, "Applicants") have not demonstrated that the rates METC proposes to collect under "Attachment O METC" of the Midwest ISO Tariff are just and reasonable. The Commission should reject METC's request to allow its proposed rates to go into effect on January 1, 2006, suspend the proposed rates for the maximum period permitted under the Federal Power Act ("FPA"), and set this case for a comprehensive hearing to examine the justness and reasonableness of METC's proposed rates.

I. COMMUNICATIONS

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II. DESCRIPTION OF FILING

On October 20, 2005, METC and the Midwest ISO submitted an Application requesting Commission authorizations and approvals necessary for METC and the Midwest ISO to: (1) utilize the proposed Attachment O METC formula rate to establish METC's revenue requirement and transmission service rates for the METC pricing zone under Schedules 7, 8 and 9 of the Midwest ISO's Transmission and Energy Markets Tariff ("EMT"); (2) use a 13.88 percent rate of return on equity ("ROE") for purposes of Attachment O METC; (3) apply the rate formula for Scheduling, System Control and Dispatch Service under Schedule 1 of the Midwest ISO EMT to the METC pricing zone; and (4) make all modifications to the Midwest ISO EMT to implement the proposed rates and related tariff provisions effective January 1, 2006. *See* Transmittal Letter at 1. Applicants state that the end result of the changes proposed in the filing is that on January 1, 2006, the rates which are currently applicable to the METC pricing zone under Schedules 1, 7, 8 and 9 of the Midwest ISO EMT will be replaced by the rates resulting from the Attachment O METC and EMT Schedule 1 Service formula rates. Under METC's proposal, its rates for

Network Service will increase significantly from \$0.98 per kW-month to \$1.5869 per kW-month. *See* Transmittal Letter at 6, 11. The rate for Point-to-Point service would change from \$0.98 per kW-month to \$0.3662 per kW-week. *Id.*

METC asserts that the tariff provisions, rates and other changes proposed in the filing are just and reasonable and consistent with FERC's policies applicable to an independent transmission-only company. Transmittal Letter at 1. In particular, METC claims that the proposed 13.88 percent ROE is consistent with the Commission's policy to promote and reward greater levels of independence and realize the attendant benefits of the independent transmission model. *Id.* at 2.

III. BASIS FOR INTERVENTION

The MPSC is an agency of the State of Michigan, created by 1939 Pub. Acts 3, Mich. Comp. Laws Ann. § 460.1 *et seq.* As the Michigan regulatory agency having jurisdiction and authority to control and regulate rates, charges, and conditions of service for the retail sale of electricity in the State, the MPSC is a "state commission" as defined in 16 U.S.C. § 796(15) and 18 C.F.R. § 1.101(k) (2005). Accordingly, the MPSC hereby provides its notice of intervention pursuant to 18 C.F.R. § 385.214(a)(2) (2005).

IV. STATEMENT OF ISSUES

In accordance with Rule 203(a)(7), 18 C.F.R. § 385.203(a)(7) (2005), the MPSC hereby provides its Statement of Issues.

1. Though characterized by METC as a request for Attachment O formula rate treatment with only limited modifications, the METC filing diverges significantly from the EMT's Attachment O.

2. METC has not justified its proposed ROE of 13.88 percent. METC offers no cost-based support for this figure, and it has not demonstrated that a 150 basis point incentive adder is justified by either business risks or concomitant benefits to consumers.

3. METC's filing lacks detail from which the MPSC can determine whether the costs of METC's new transmission facilities are just and reasonable. Further, orders approving METC's cost deferrals specifically refer to "new transmission facilities," but do not address acquisitions of existing transmission. METC has not shown why the costs of such facilities were eligible to be deferred and/or why an incentive ROE adder is appropriate for the investment in such facilities.

4. The METC filing does not provide adequate support for METC's proposed operation and maintenance ("O&M") and other expenses.

5. METC does not offer sufficient support for its adjustment to its equity balance. The MPSC is unable to determine if \$57,731,906 is the correct adjustment amount.

6. Without the information that has been designated as proprietary information by METC, it is impossible to determine if the income tax adjustment proposed by METC is justified under Commission policy.

7. The Commission should suspend METC's proposed rate increase for the maximum suspension period under the FPA. *West Texas Utilities Co.*, 18 FERC ¶ 61,189 (1982).

V. PROTEST

A. Overview

METC contends that its proposed rates are just, reasonable and consistent with Commission policy and precedent, and urges the Commission to accept the proposed changes without refund, suspension or hearing and allow them to go into effect on January 1, 2006. Transmittal Letter at 19. The MPSC strongly disputes METC's claim that the proposed rates are just and reasonable. Further, the MPSC does not agree that METC's rates are necessarily consistent with Commission policy and precedent. As the Commission stated in its order conditionally authorizing the establishment of METC:

Our conditional approval of the proposed transactions is based on the specific facts present in this case, including the scope of the Applicants' proposal, which resolves numerous complex issues associated with the creation of an independent stand-alone transmission business from a vertically integrated utility, and the lack of substantial intervenor protests.

Trans-Elect, Inc., 98 FERC ¶ 61,142 at p. 61,415 (2002).

The MPSC agrees with the Commission that the establishment of METC involved a number of complex issues. In this regard, this is the first rate case for METC since it was established, and it is imperative that the MPSC and other affected parties have a full opportunity to investigate the manner in which METC proposes to address these "complex issues" in its proposed formula rates. Further, METC's cost proposals warrant further scrutiny at a hearing – including the proposed 13.88 percent ROE, the proposed level of deferral associated with investment in new transmission facilities, O&M expense, the equity balance adjustment, and METC's income tax allowance.

Accordingly, the Commission should suspend the proposed rate increase for the maximum period permitted under the FPA, set METC's proposed rates for hearing, and only allow the rates to go into effect subject to refund pending completion of the hearing.

B. Issues Requiring Investigation

1. Formula Rate Proposal

Though characterized by METC as a request for Attachment O formula rate treatment with only limited modifications, the METC filing diverges significantly from Attachment O. Contrary to Attachment O, METC is filing for formula rate treatment early; is not using the previous year's cost data; and, other than its proposed true-up procedure for deferral amounts for actual transmission investments, appears to be proposing to use 2004 cost data for eighteen months, rather than the one-year term for Attachment O formula rates.

Per the EMT, Attachment O updates would be made prior to June 1 of each year, allowing for inclusion of complete FERC Form 1 data from the previous year. Form 1 filings are due to FERC by April 18 of each year. METC's complete 2005 Form 1 data would be available by April 18, 2006. Instead of waiting until 2005 Form 1 data are available, however, METC is proposing to use 2004 Form 1 data with a true-up for 2005 deferred amounts only for rates effective January 1, 2006 – May 31, 2007. If METC's request were approved without modification, the next Form 1 cost data used for METC rates effective June 1, 2007 – May 31, 2008 would be 2006. From the minimal information filed, it appears that other actual 2005 METC costs would be ignored except for the requested one-time true-up mechanism to reconcile the difference between the use of a projected 2005 deferral balance versus an actual 2005 deferral balance. Though offering reassurance that use of the projected 2005 deferral balance would only be for a short time, METC does not propose including in the true-up any other actual

2005 costs. Since METC proposes a true-up filing anyway, it makes more sense from an accounting perspective to include all actual 2005 costs in the one-time true-up filing. Also, although FERC has authorized METC to recover its deferrals beginning January 1, 2006, that does not mean that METC should begin collecting costs incurred December 31, 2005 in rates starting on January 1, 2006.

METC asserts that FERC has authorized it to begin recovery of the deferred costs beginning January 1, 2006, and that its current stated rates expire December 31, 2005. But METC could have requested an extension of the current stated rates for six months beginning January 2006, in addition to beginning the previously authorized recovery of the deferral amounts January 2006. It could have also requested Attachment O formula rates based on 2004 cost data for the first six months of 2006, done a subsequent true-up for all 2005 costs, followed by use of the EMT Attachment O formula schedule in mid-2006, like other MISO TOs. Rather, METC overly and unnecessarily complicates the achievement of its goals by combining its request for formula rates with the deferral recovery and a true-up using selected actual 2005 data. Based on the foregoing, METC's proposed implementation of the Attachment O METC formula rate should be evaluated at a hearing.

2. Return on Equity

METC requests an ROE of 13.88 percent, which it contends is supported by the testimony of its witness James H. Drzemiecki. Mr. Drzemiecki explains that this figure was derived from "the prevailing baseline ROE for MISO transmission owners (12.38%), plus an additional 150 basis point adder to reward and compensate METC for the customer benefits and increased business risks, respectively, associated with independent ownership." Exh. MET-4 at 5. As discussed below, METC has not adequately justified its proposed ROE.

As an initial matter, the 12.38 percent “prevailing baseline ROE for MISO transmission owners” was derived in Docket No. ER02-485-000 as an appropriate cost-based rate for Midwest ISO TOs based on prevailing market conditions at the time.¹ Indeed, the Commission vacated its grant of a 50-basis point non-cost incentive adder to the 12.38 percent figure after the D.C. Circuit ruled that the Commission had not put parties on notice that non-cost incentive ROE adders would be at issue in the hearing in Docket No. ER02-485-000. *See Midwest ISO*, 111 FERC ¶ 61,355 (2005). METC provides no substantial evidence to support a finding that 12.38 percent represents an appropriate baseline *cost-based* ROE for METC under current market conditions. Neither Mr. Drzemiecki nor any other METC witness supports the 13.88 percent figure with a discounted cash flow (“DCF”) or other quantitative analysis of the cost-based return on equity that would be required by investors under current market conditions. Also, the data underlying the DCF analysis that produced the 12.38 percent baseline ROE in Docket No. ER02-485-000 are now several years out of date,² and it is MPSC’s belief that a DCF analysis of the appropriate cost-based ROE for METC under current conditions could be significantly less than 12.38 percent. For this reason alone, the Commission should set METC’s proposed ROE for hearing.

Mr. Drzemiecki maintains that the 13.88 percent ROE requested here is supported by the policies and precedent underlying the Commission’s approval of a 13.88 percent return on METC’s deferral amounts. *See* Exh. MET-4 at 6-9. While conceding that the Commission approved this ROE *only* for purposes of METC’s deferrals (*id.* at 8), Mr. Drzemiecki contends

¹*See Midwest Ind. Sys. Op., Inc.*, 100 FERC ¶ 61,292 (2002), *reh’g denied*, 102 FERC ¶ 61,143 (2003), *on remand*, 106 FERC ¶ 61,302 (2004), *reversed in part*, *Public Serv. Comm’n of Kentucky v. FERC*, 397 F.3d 1004 (D.C. Cir. 2005), *order on remand*, 111 FERC ¶ 61,355 (2005).

² The DCF results in Docket No. ER02-485-000 were generally based on economic data from 2001 and 2002. *See, e.g., Midwest ISO*, 99 FERC ¶ 63,011 at p. 65,053 (2002).

that “any action by the Commission in this proceeding that would reduce METC’s ROE below 13.88 percent would signal a weakening of the Commission’s commitment to infrastructure growth through independent ownership.” *Id.* at 8. In the absence of any analysis of an appropriate cost-based (*i.e.*, investor-required) ROE for METC, however, there is no substance to Mr. Drzemiecki’s suggestion that investors would view an ROE less than 13.88 percent as indicative of a retreat by the Commission from promoting independent transmission ownership.

Of particular significance, according to Mr. Drzemiecki, is the Commission’s approval of a 13.88 percent ROE for International Transmission Company (“ITC”):

Of particular relevance was the Commission’s decision in *ITC Holdings, Inc.*, 102 FERC ¶ 61,182 (2003), where the Commission described the unique risks of independent transmission companies and the need to compensate for such risks in the form of higher ROEs. The Commission agreed with METC that the requested 13.88 percent ROE and proposed target capital structure conformed to the rate approvals granted other independent companies, specifically ITC Holdings, and that the Commission was committed to promoting, as a matter of regulatory policy, independent ownership and operation of transmission assets. (MET-4, page 6).

ITC’s ROE of 13.88 percent, however, reflected FERC’s approval of ITC’s request for an ROE of 100 basis points above that approved by the Commission for other Midwest ISO TOs in Docket No. ER02-485-000. In an apparent effort to sidestep this inconvenient fact and still get to 13.88 percent, METC simply asks for a 150 basis point adder instead of the 100 basis point adder approved for ITC. Mr. Drzemiecki further suggests that the Commission must grant METC an ROE similar to ITC. Mr. Drzemiecki contends that “[a]s a matter of law, and consistent with notions of fundamental fairness and sound economic/regulatory policy, the Commission may not authorize different or preferential equity returns for similarly-situated companies.” Exh. MET-4 at 7. Contrary to Mr. Drzemiecki’s argument, METC cannot justify

an ROE at a certain level simply by pointing to an ROE for a different company if that ROE was based on data reflecting different market conditions.

Thus, the alleged justifications for the 150 basis points adder that METC is requesting should be set for hearing, including whether it is appropriate to grant a higher ROE as an “incentive” for independence even though METC has been an independent transmission company for several years, whether the incentive adder that METC requests is calibrated to the benefits that consumers can hope to obtain from independent ownership and operation of transmission assets, and the extent to which METC faces business risks that could justify the adder, as Mr. Drzemiecki suggests.³

Because METC has not shown that its proposed 13.88 percent ROE is just and reasonable, and because there are numerous material issues of disputed fact relating to an appropriate cost-based ROE for METC and the appropriateness of an incentive adder, if any, the Commission should set for hearing all issues pertaining to the proper ROE for METC.

3. Deferral of Investment in New Transmission Facilities

In its orders approving METC’s acquisition of the transmission facilities formerly owned by Consumers, the Commission provided for deferred recovery of depreciation and return on investment in new transmission facilities incurred during the period January 1, 2001 through December 31, 2004 (this was later extended to December 31, 2005).⁴ In the instant filing, METC includes \$99,483,989 of deferrals, which includes actual regulatory deferral balances for

³ Mr. Drzemiecki’s suggestion that the 150-basis point adder is warranted, in part, by “business risk” indicates that he believes that the 150-point adder may be justified partially on cost grounds. *See* Exh. MET-4 at 5. But aside from a single passing reference to “increased business risks . . . associated with independent ownership” (*id.*), Mr. Drzemiecki does not discuss these alleged business risks, nor does he draw a connection between any such risks and the level of increased return required to fairly compensate for the risks.

⁴ 98 FERC ¶ 61,142; 98 FERC ¶ 61,368; and 107 FERC ¶ 61,206.

2001 through 2004, plus estimated deferrals for 2005.⁵ METC proposes to recover the deferral over a five-year period from January 1, 2006 through December 31, 2010.

METC briefly indicates in its filing that it “acquired additional transmission facilities.” Transmittal Letter, footnote 7. METC and Wolverine Power Supply Cooperative also recently received authorization, subject to conditions, from the Commission for the disposition and acquisition of jurisdictional facilities resulting from the sale of transmission facilities by Wolverine to METC. *Michigan Elec. Trans. Co., LLC*, 113 FERC ¶ 62,094 (2005). The Commission’s orders authorizing deferrals for METC specifically refer to “new transmission facilities,” but do not address acquisitions of *existing* transmission. Thus it is unclear how acquisition of transmission facilities should be treated. Existing transmission is in many cases already partially paid for, and is not necessarily characterized by the same capital attraction needs that the Commission has found warrant incentives for new transmission. The filing lacks details on how much of the cost of “new” transmission facilities is for newly built facilities and how much is for acquired facilities.

More generally, METC’s filing lacks detail which would enable the Commission to determine whether the costs of new transmission facilities are just and reasonable. The cost data have been compiled into a summary of several general categories. *See* Exh. MET-3 at 3. There is no description by project which would allow one to determine METC’s overall strategy in choosing these projects. METC witness Paul McCoy includes an explanation of METC’s philosophy of transmission and describes several projects that METC has undertaken. *See* Exh. MET-7. However, Mr. McCoy does not link these projects to specific cost figures, or explain how METC determined that those projects were needed. Generally, the costs included in the

⁵ Exhibit MET-3 shows METC transmission plant in service additions of \$117,914,943 actual 2001 through 2004 plus \$26,932,120 estimated for 2005.

filing lack supporting data, do not clearly show that the costs are incremental to costs already included in rates from the original transfer of facilities, and do not demonstrate reductions for any contributions from others, such as generators. Accordingly the Commission should set such issues for hearing.

4. O&M & Other Expenses

The METC filing does not provide supporting documentation for proposed O&M expenses sufficient to allow the MPSC to determine whether the costs are just and reasonable. The O&M costs are a critical part of the rate filing, yet METC provides no data on the number of employees, the cost of running the METC facilities or other supporting expenses.

It is clear, however, that METC has included the costs that were paid to Trans-Elect as a result of a contract that METC has with Trans-Elect to provide services to and for METC. *See* Exh. MET-4 at 11-14. Although METC may be receiving benefit from the expertise of Trans-Elect's executive/managerial support and regulatory services through their Management Services Agreement (MSA), there is insufficient information presented in this filing to determine whether any of these services are duplicative or otherwise unreasonable.

Also, Consumers Energy employees are still responsible for operation of the METC system. The filing makes no mention of what METC is paying Consumers Energy to provide this service.⁶ Additional supporting documentation should have been provided in this filing to make it possible to determine whether the costs are just and reasonable. Thus, the Commission should set METC's proposed O&M costs for hearing.

⁶ This fact may also be relevant to the question of the extent to which, if at all, METC is entitled to an incentive ROE adder for independence.

5. Adjustment to Equity Balance

METC is requesting an adjustment to its equity balance to eliminate the effect of Generally Accepted Accounting Principles required push-down accounting. *See* Transmittal Letter at 4. METC is decreasing its equity balance by \$53,731,906 to comply with this “requirement.” The MPSC has not made a determination on the appropriateness of this adjustment and submits that more information is necessary, including how the amount was determined.

6. Income Tax Allowance

METC has proposed an income tax allowance of \$15,723,423 to represent the income taxes on the equity return. *See* Exh. MET-1 at 13. According to METC witness James Drzemiecki: “Under Commission policy prevailing at the time Trans-Elect was negotiating with potential investors (with respect to both the initial financing and the subsequent refinancing), a tax allowance was permitted to limited liability companies, subject to (and to the extent of) corporate ownership of the LLC interests.” Exh. MET-4 at 10. METC has included support for this allowance in affidavits and related materials that were submitted with the filing under Attachment A.

Most of Attachment A was deemed to be proprietary and was designated as Protected Materials by METC. The portions of Attachment A that were so designated contain the schedules which show allocation percentages attributable to the taxable income of the METC equity owners and taxable income for the METC equity owners. The MPSC submits that parties should have the opportunity to address METC’s proposed tax allowance, including the adequacy of METC’s Attachment A information, at an on-the-record hearing.

C. Request For Suspension

METC asks that the proposed rates be allowed to go into effect on January 1, 2006, and asserts that any suspension should be limited to a nominal period. *See* Transmittal Letter at 20. The Commission's policy is that it will suspend proposed electric rate increases that appear to be substantially excessive for the full five-month statutory period under the FPA. *See American Elec. Power Serv. Corp.*, 111 FERC ¶ 61,305 (2005); *West Texas Utilities Co.*, 18 FERC ¶ 61,189 (1982). The Commission defines "substantially excessive" to be where more than ten percent of the proposed increase is excessive. *See id.* Here, it appears that METC's proposed rates may be excessive by more than 10 percent. METC's requested return allowance of \$41,212,529 alone constitutes 32 percent of METC's proposed revenue requirement of \$129,153,877. Given METC's complete lack of support for a cost-based ROE at the level requested, the problems the MPSC has identified with METC's proposed incentive adder, and the other cost items identified herein as warranting investigation, METC's proposed rates may very well be at least 10 percent excessive and warrant suspension. Accordingly, the Commission should suspend the proposed rates for the maximum five-month period under the FPA.

VI. CONCLUSION

WHEREFORE, the Michigan Public Service Commission hereby provides notice of its intervention. The MPSC asks the Commission to reject METC's request that its proposed rates be effective on January 1, 2006 and set this case for a comprehensive hearing to examine all of the issues raised by the MPSC. The costs that support METC's request for an increase need to be carefully reviewed in order to determine whether they are just and reasonable. Further, METC is exiting a rate freeze period and is, at the same time, moving from a stated rate to a

formula rate. The convergence of these two events increases the importance of ensuring that the costs underlying this transition are appropriate.

Respectfully submitted,

**THE MICHIGAN PUBLIC SERVICE
COMMISSION**

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CERTIFICATE OF SERVICE

I hereby certify that I have this day served copy of the foregoing document upon all parties listed on the official service list compiled by the Secretary in this proceeding.

Dated at Washington, D.C. this 10th day of November, 2005.

John E. McCaffrey

John E. McCaffrey

Submission Contents

69130461.pdf.....	1-16
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